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The Big Picture

CONTENTS

Our National Accounting System 1
The National Flow of Output and Income 4
Fitting the Parts Together 13
A Dynamic Economy Involves Change 13
The Significant Role of Consumer Spending 16
The Significant Role of Business Investment 18
The Significant Role of Government Spending and Taxing 19
Demand and Inflation 21
Our Free and Dynamic Economy Has Its Ups and Downs 23

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The Big Picture

OVER-ALL COMPARISONS of the Soviet and the United States economies are complicated by many statistical problems.

Statistical information on the Soviet economy is increasingly available, but the volume is still meager compared with data about the United States.

Even when Russian statistics are obtainable, the economist and statistician must regard them with suspicion.

The Communists' preoccupation with secrecy and their desire to present a favorable propaganda picture may cause them to withhold and suppress data, to select only figures favorable to them or to make their reports deliberately obscure.

As a result, American research specialists must painstakingly put together bits and pieces of information that can be found in scattered Soviet sources.

Our National Accounting System

IN STRIKING CONTRAST to the limited statistical information on the Soviet Union is the abundant material on the United States. Of special interest to us is information developed as part of our national accounting system—a measurement of over-all production and national income.

Every business uses some kind of accounting system. It may be a simple set of books in which the proprietor keeps records on the costs of his merchandise and the volume of his sales. In a larger business, an elaborate and complex accounting system may cover every aspect of the firm's activities.

Statisticians and economists have worked out a system of accounting for the national economy of the United States.

Soviet economists and statisticians have their own system.

Differences in the two systems of accounting are one reason why it is so difficult to compare the two economies.

In our accounting system, for example, we use the term "national income" and report the size of this income in dollars. The Soviets compute "national income" somewhat differently. In fact, the type of information on national income and national production that economists depend upon in studying economic structure and growth in the United States and Western European countries is not published in the Soviet Union.

In preceding pamphlets, we saw that our economy is built primarily on private enterprise, but government plays a big role.

Our national accounting system covers the activities of *both* government and what is called the private sector of the economy. (The national accounting system should not be confused with the government's budget, which is concerned only with government revenues and expenditures.)

Production generates income. *National economic accounting, essentially, is designed to measure the nation's production and to indicate how the income generated by it flows through the economy.*

The development of a national accounting system makes economics and economic analysis more of an exact science. It reduces glib generalizations about the state of the economy and makes possible the measuring and evaluation of changes.

National income statistics prepared by the Department of Commerce on the flow of income and production are widely used by both government and business. Some familiarity with them will give us a better picture of our economy as a whole and also serve as a guide in understanding many of the terms used regularly by newspapermen, magazine writers, radio and television commentators, economists, and politicians in discussing our economic health.

Most important, our national accounting system can help give us the "big picture"—a spaceman's view of our whole economy.

National economic accounting—more generally called national income analysis—has developed largely since the Great Depression of the 1930s. As a tool, it is politically neutral and can be used by people of all shades of opinion. But, like other tools, it should be used cautiously.

Most economists accept national income analysis, but some question certain underlying concepts on which it rests.

For example, economist Murray N. Rothbard, writing in the *New Individualist Review*, charges that the system contains hidden assumptions.

It is based on the theory, according to Rothbard, "the national product is something like a pie, consisting of several 'sectors' and these sectors, public and private alike, are added to make the product of the economy as a whole. In this way, the assumption is smuggled into the analysis that the public and private sectors are equally productive, equally important, and on an equal footing altogether. . . ." [1]

Without going into the controversial question of whether the government sector of the economy is productive, it can be recognized that there *are* differences between the private and the government sectors.

In the private sector, consumers make their wants known by their purchases. Their decisions to buy—or not to buy—are reflected in changing prices that serve as signals for producers.

In the government sector, people make their wants known through votes, as expressed by their representatives in public office. Every government program represents a choice among alternatives. In effect, the political vote is substituted for the dollar vote of the market place. We exercise our freedom of economic choice—we decide what products our money buys—by voting for government officials who will spend it for us.

Another difference lies in the fact that consumers pay for the things they want in the market on an individual, voluntary basis. You voluntarily select a suit and pay $60 for it. Presumably, there is a relationship between the $60 and the value of the suit you receive.

Some types of government services are voluntary. You can decide whether to buy a book from the Government Printing Office. You may, or may not, go to a state-supported university. But many other government services are compulsory and of such nature it is impossible to determine the exact amount of the service used by one individual. How can one unit of police protection or one unit of national defense be measured?

In private business, prices, profits and wages provide useful yardsticks for measuring efficiency. In the private economy, a product or service that costs more to produce than it is worth to the free consumer ceases to be produced. No yardstick comparable to "profit-and-loss" is available to measure government activities.

As long as we recognize, however, there are basic differences between government and private activities which are not emphasized in national income accounting, it can be useful in helping us trace the flow of products and income among the three major areas of our economy—consumers, business and government. More importantly, it may help us understand how changes in one of these areas affect other areas and the whole economy.

The National Flow of Output and Income

NO MATTER HOW COMPLEX a firm's accounting system may be, the managers are concerned with (1) the value of the goods they produce and sell and (2) the costs of production.

Similarly, the national accounting system is concerned with the value of all the goods and services the nation produces.

But it goes one simple step further on the cost side than usual business accounting. When business firms pay out money for labor or raw materials, these costs to the business become income for others. National income accounting makes its reports in terms of *income*.

National income analysis, in short, measures total production and then traces the flow of income generated by this production step-by-step through the economy until it reaches the point where you and your neighbor spend it or save it.

Five of these steps are of special interest to us—the Gross National Product, the Net National Product, the National Income, Personal Income, and Spendable (or Disposable) Income.

Let's look at each one of them briefly.

The Gross National Product

HOW BIG IS OUR ECONOMY? Are we producing more goods and services this year than last? What is our total production?

When a businessman speaks of his "gross volume," he means the total value in dollars of all the goods he produced or sold in some stated period of time. Similarly, economists have set up a measuring rod for our economy. It is the total value in dollars of all the goods and services produced in the economy during some period of time and it is called the Gross National Product (GNP)—a term used in previous pamphlets.

Estimating the Gross National Product is no easy job for government economists and statisticians. They have had to set up certain rules and procedures as guides.

For one thing, they include in the Gross National Product only the final selling price of *final* products. A mining company sells iron ore to a company which turns it into steel. A company buys the steel to make washing machines. Only the final selling price of the final product—the washing machine—is included in Gross National Product. The cost plus the profit the mining company received for producing the ore, the cost of producing the steel and the profit earned by the steel company, the costs of the manufacturer of the washing machine and his profit—all of these are included in the final sales price.

The value of services—doctors' services, police protection, and so on—are included in the GNP although, interestingly enough, the value of all the housekeeping duties performed by wives are not included. In other words, if you pay a maid to clean and dust your home and prepare your meals, the value of these services, as measured by what you pay her, is included. If your wife performs the same chores, the value of the services is not included—largely because it would just be too difficult to measure.

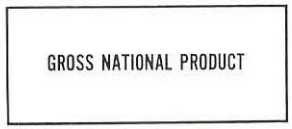
Nor are the millions of dollars worth of volunteer services performed each year for chambers of commerce, churches, the Red Cross, hospitals, and other organizations included in the GNP.

The composition—the types and quantities of goods and serv-

ices—of the Gross National Product is important. For example, during World War II, war material represented a large portion of it. Consumer goods were in short supply. But, generally speaking, year in and year out, some idea of the state of the economy can be obtained from the size of the GNP.

The size of the GNP, of course, can go up as the result of inflation without any increase in actual production. For example, the GNP in 1960 was over $500 billion dollars. In terms of 1954 dollars, it was $440 billion.* But, when inflation is compensated for by measuring the GNP in dollars of the same value, we can tell many things about the over-all economy. If total production is growing faster than the population, most of us are better off.

Let us now put the first block in a chart that will help us see "the big picture."



All the final goods and services produced in one year in the nation, measured by the prices paid for them.

Soviet GNP

ECONOMISTS HAVE SPENT a tremendous amount of time and energy estimating the Gross National Product of the Soviet Union. The problem is made difficult, not only by lack of statistics, but because the value of the Russian ruble varies from product to product and because different methods of computation are used in the Soviet Union.

Some Soviet statisticians use a "double system of counting." Whereas we consider only the value of a final product, such as a refrigerator, on the theory that all costs are included in it, they may count both the value of the steel and the value of the refrigerator. This system of accounting obviously boosts the size of the GNP. On the other hand, there is evidence that they do not give as much weight to services as we do—which tends to decrease their GNP in comparison with ours.

*All national income statistics used in this pamphlet are estimates from *Survey of Current Business,* May 1961, and are subject to later revision.

Although some experts set the figure lower, most estimate the Soviet Union is now producing about half as much as we are. Their GNP is slightly less than half the GNP of the United States.

Much of the discussion of the Soviet growth rate is related to the increase in their Gross National Product. While comparative figures on national product offer a convenient measure for over-all economic capability, they do not provide answers to many economic, military, scientific and political questions.

For example, it is estimated that the Soviet Union with a Gross National Product somewhat less than half as large as that of the United States is devoting about the same amount to defense. This fact is important, but it still leaves unanswered many questions on the relative strength of the two nations from the standpoint of aircraft, missiles, ships, state of troop training, morale, and so on.

Who Buys the GNP?

THE GROSS NATIONAL PRODUCT is the value in dollars of final goods and services that are produced. But GNP could be expressed in terms of actual goods and services: hair-cuts and "hot dogs," police protection and planes, giant earthmovers and tiny transistor radios.

In arriving at their figures for the GNP, the statisticians analyze who purchased all these goods and services and they report the total in terms of the purchases by three main groups in the economy—individual consumers like you and your neighbors, investors (or business) and government.

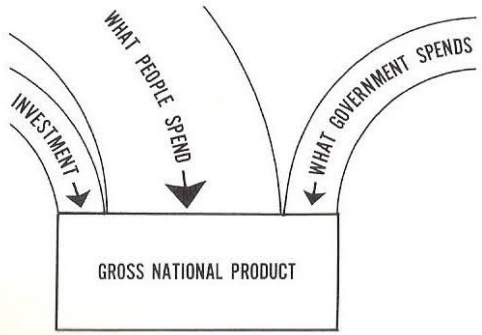
Foreigners also buy a substantial part of our Gross National Product. But exports are partly balanced by imports. Thus, the short-time impact of foreign transactions may be comparatively small and they are omitted from this discussion. It should be pointed out, however, that changes in our foreign accounts over a period of years can accumulate to a size that may affect our economic stability.

Individual Consumers. You and your neighbors buy most of the final products that make up the GNP. In 1960 you paid

$328 billion for goods and services including $71 billion for food, $43 billion for housing, $28 billion for clothing, $18 billion for automobiles and a whopping $131 billion for services—such as haircuts, bus fare and dry cleaning. In fact, judging by the proportion of the GNP devoted to services, you and your neighbors are spending an increasing share of your income on services rather than on goods.

Government purchased about one-fifth of the Gross National Product in 1960 to provide goods and services, including those furnished by mailmen, military bands, migratory bird commissions and members of Congress.

Investors make up the third major group of buyers of the GNP. Investors as used here means those who purchased capital goods, such as plants and machinery. Investors purchased about one-seventh of the national output in 1960, mainly to modernize and expand their industrial plants and productive facilities.



Investors, consumers and government buy the goods and services that make up the GNP.

The Net National Product

THE NEXT TERM that comes up in our national income accounting is Net National Product.

What is the difference between the Gross National Product and Net Product?

Remember we are trying to find out what the economy produced and the income that was generated by it. We all know

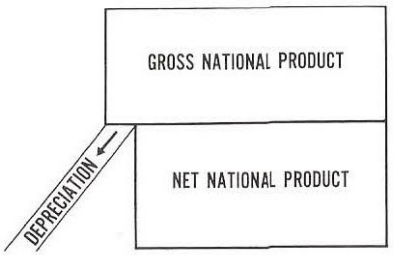
that accountants and businessmen use the term "net" to indicate what remains after costs are deducted. Is there any big cost we should deduct from our gross national product to make the picture more accurate?

There is one such cost—depreciation.

Here is a simple illustration. Suppose you go into the firewood business. You buy a power saw for $100 and with it saw wood that sells for $1,000. When you are finished, your saw is worn out. Your gross product was $1,000. It would be included in the Gross National Product. To ignore the fact that you had worn out a saw, however, would be misleading. If you spent your entire $1,000, you would not be able to buy another saw and your ability to cut firewood would be reduced.

A far more accurate appraisal of your production would be $900—deducting the cost of the saw. Similarly, the economists who measure the whole economy try to make allowances for the replacement of capital used up—depreciated—in the production process.

Some economists feel that one reason for recent Soviet growth is that Russia's industrial machine is both smaller and newer than the industrial machine of the United States. As a result, less needs to be set aside for depreciation. Available resources can be used for new equipment. Over a period of time this situation will change, of course.



Gross National Product *minus* depreciation allowances equals Net National Product

National Income

SO FAR WE HAVE been talking about the value of the goods and services produced. Now we have to shift to the *income* gen-

erated by that production. The National Incomes goes to those who produce. Most of this income is distributed to employees, lenders, and owners in return for their productive services.

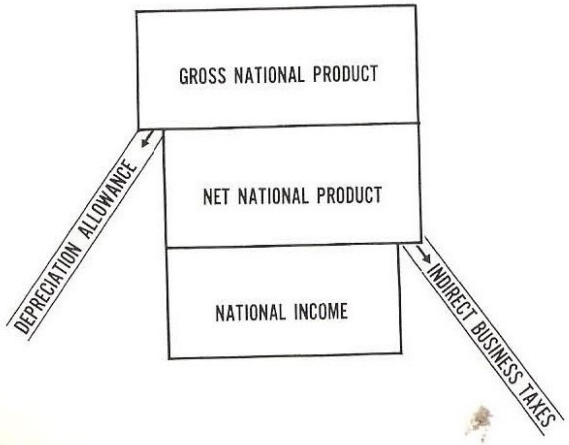
Before we can measure National Income accurately, we must make a deduction from the Net National Product.

Remember the Gross National Product and the Net National Product are measured in terms of the value of final products.

The market value of a package of cigarettes is included. Perhaps the cigarettes cost 25 cents. But 10 or 11 cents of this represent taxes. To measure accurately the value of the cigarettes, we must deduct sales taxes and other indirect business taxes that are siphoned off by government.

After those taxes are deducted we have a figure for National Income.

In 1960 these indirect taxes amounted to some $45 billion—about 9 percent of the Gross National Product of the United States. As we saw in Pamphlet 5 (*The Role of Government*), the Soviet Union relies heavily on "turnover taxes"—which are included in the price of consumer goods. One authority has estimated that these indirect taxes account for one-fourth of the Gross National Product in the Soviet Union at established prices.[2]



National Income is Net National Product minus sales taxes and other indirect business taxes

Personal Income is Our Personal Income Before Personal Taxes

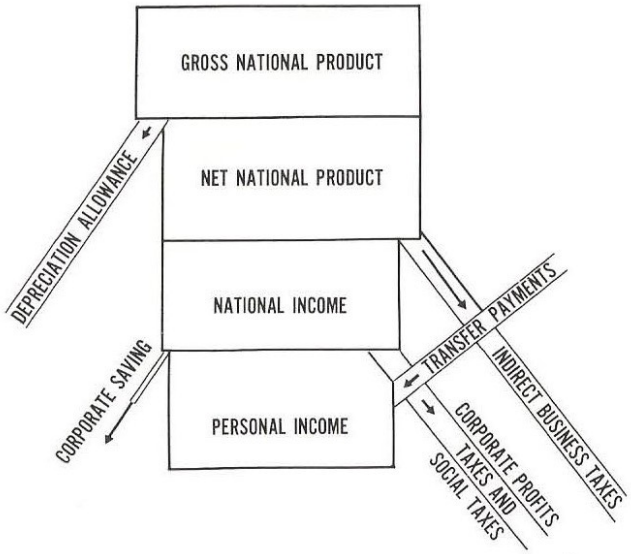
NATIONAL INCOME INCLUDES the incomes of businesses. Obviously not all of this income is distributed to individuals.

Business saves some of its income to invest in new plant and equipment. Business also pays taxes on its profits and various forms of social security taxes.

Corporate savings and business taxes must therefore be deducted before we can measure Personal Income—the income going to individuals.

Personal Income includes wages, salaries, dividends received by shareholders, and interest and rent paid to those who own property. Another item of Personal Income is what the economists call transfer payments. Pamphlet 5 (*The Role of Government*), referred to these payments made to individuals in the form of social security, unemployment compensation, welfare benefits and so on. Also included is interest the government pays on money it has borrowed.

Transfer payments are different from the income that is generated in the production process. They are called transfer

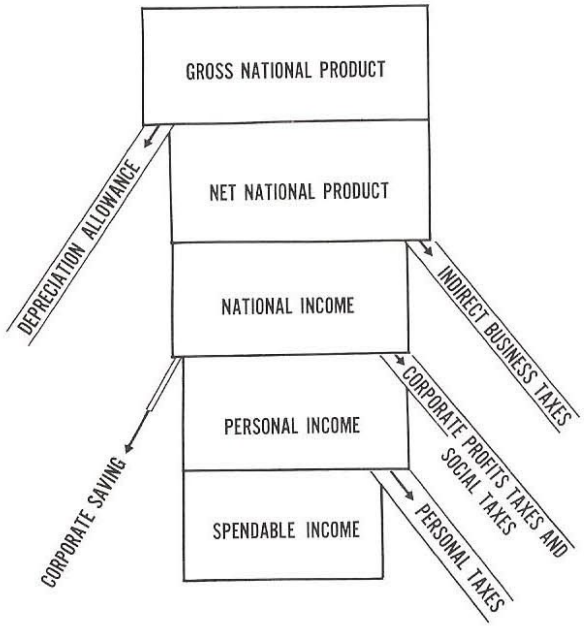


Personal Income is National Income *minus* corporate savings and corporate and social taxes *plus* transfer payments.

payments because, essentially, they transfer money from some individuals, through government, to other individuals. As we will see later, these payments may help support purchasing power during a downswing in the economy, but they are not directly linked to production.

Spendable Income (Disposable Personal Income)

WE NOW COME to the part that concerns us most—take-home pay. It's what we have left to spend or save—after all deductions such as income and property taxes. The spendable personal income section of our national accounting system is the best measure of the nation's take-home pay. It is officially called Disposable Personal Income; you can "dispose" of it as you wish in a free country.



Spendable Income is Personal Income *minus* personal taxes.

Fitting the Parts Together

FIGURE 1 *(page 14)* WILL HELP you see how all these segments of the national accounting system fit together; it will help you see "the big picture."

The flow of national income has been compared to three rivers and their tributaries forming drainage systems. It has also been referred to as the "race-track chart."

On the main race track run the dollars received by you and your neighbors as payments for your contribution to production. After you pay taxes and set aside savings, you purchase goods and services as consumers.

On the race track of savings and investment run the dollars that have been set aside as savings, either by you or by business. As these savings are invested, they pay for used-up capital goods and for new capital goods.

On the government race track run the dollars that are collected in taxes (or borrowed) by government. Some of these dollars are used by government to buy goods and services from the GNP and others are transferred to individuals as personal income.

The trouble with this comparison to three race tracks is that developments on one track materially affect developments on another track. They are all linked together. Dollars start running on the main track and then break away to the left or right to run on the savings track or the government track.

A Dynamic Economy Involves Change

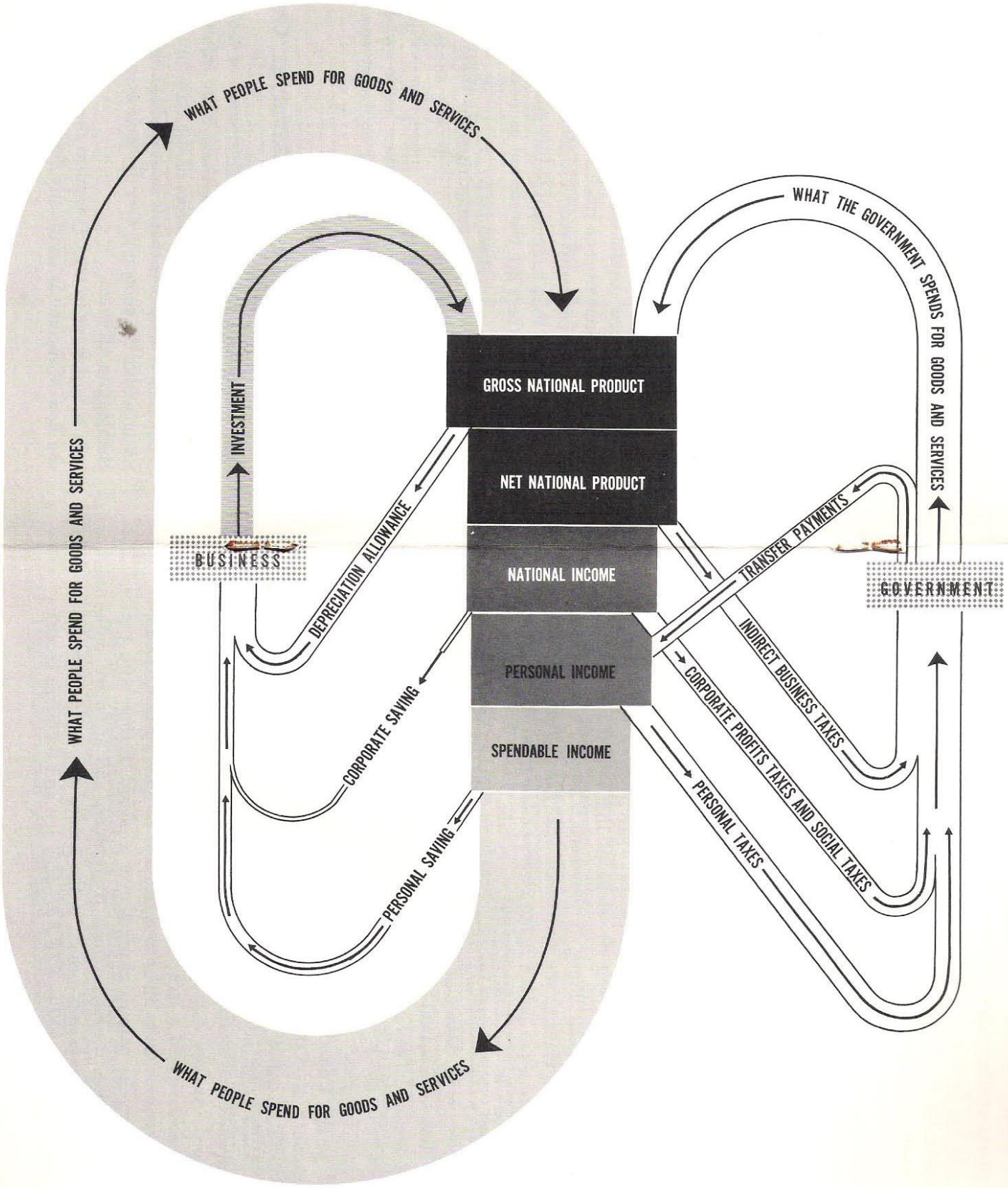
ONE WEAKNESS IN THIS graphic illustration of the national income flow is that it does not show basic differences in the government and private sectors of the economy.

Another weakness is that it may inadequately depict movements within the economy. Our dynamic economy is constantly changing in all areas.

It is important to try to visualize these movements because the flow of income is constantly shifting. Change in one area

FIGURE 1

FLOW OF INCOME AND SPENDING



affects another, which, in turn, affects another.

It has been pointed out that the goods and services which make up the Gross National Product are purchased by consumers, investors and government. The three groups make up what—economists call "total" or "aggregate demand." Changes in any one of these areas inevitably affect aggregate demand—and changes in aggregate demand have major effects on the economy. This subject will be explored more fully in Pamphlet 7 which deals with inflation, unemployment, and growth, but let's examine briefly three significant areas: consumer spending, business saving and investment, and government spending and taxation.

The Significant Role of Consumer Spending

ONE ECONOMIST HAS estimated that aggregate Soviet consumption in 1955 was about two-fifths of the United States level measured in dollar terms. If allowance is made for the difference in population, the difference was even greater—Soviet consumption per person being at about one-third the level of a person's in the United States.

Such a comparison, of course, does not tell the whole story. For example, Soviet per capita consumption levels are closer to those of the United States in terms of food and basic types of clothing. They are much further behind in terms of durable consumer goods—refrigerators, furniture, etc.—housing and personal services.[3]

In the United States in 1960, out of a total gross national product of $503 billion, consumers purchased $328 billion worth of goods and services.

Millions of independent consumers, by their "dollar votes," influence the kinds and quantities of goods and services produced. As they shop in competitive markets, consumers shape the economy to a large extent.

Most consumers cling to their habitual pattern of spending although the pattern changes over a period of time with the introduction of new products by business and in accord with changing needs and desires of the American people. The demand for automobiles a few decades ago and the more recent

demand for detached houses in the suburbs (as opposed to "row" houses in the city) are oft-cited examples of basic shifts in consumer demand.

Occasionally, consumers as a group decide to spend more and save less of their income or spend less and save more. These changes have significant effects on the economy.

The Acceleration Effect of an Increase in Consumer Spending

THE SLIGHT MOVEMENT of your foot when you push down on the accelerator of your car greatly increases your speed. Similarly, a change in consumer spending may induce a much larger increase in investment, production and income.

A simple example can make this more understandable.

Suppose millions of families suddenly decide to buy a color television set. Dealer stocks would soon be depleted. To replenish their inventories and to meet rising demand, dealers as a group would greatly increase their order from suppliers. Suppliers would follow suit.

To fill these new orders, manufacturers would start to expand production. To do this they would invest in new machinery and raw materials. In short, the original increase in buying by consumers started a series of actions which caused a much larger increase in inventories and productive facilities.

An increase in demand usually tends to cause a much greater increase in investment. Economists refer to this as the *accelerator* and use this principle to help explain fluctuations in our economy.

The expansion caused by the accelerator effect, of course, cannot go on indefinitely. As the demand for color television starts to level off, new investment in plants and equipment begins to decline.

The Deceleration Effect of a Reduction in Consumer Spending

ON THE OTHER HAND, if you and millions of other consumers reduce your spending, the effect is the opposite of acceleration. If consumers reduce their spending for black-and-white television, businessmen will cut back on investment in machinery

and raw materials. This deceleration effect may cause a much greater contraction in the economy than the size of the change in consumer spending.

The Significant Role of Business Investment

BUSINESS, OF COURSE, spends money for a variety of things—wages, plants, equipment, transportation, and so forth. But for our purposes here, the crucial kind of business spending is for inventories, capital goods, machinery and facilities. Rising business investment in inventories and productive capacity is usually the signal for an upturn in the economy.

Changes in total business investment are especially significant because they can start chain reactions in our economy. (Changes in the net spending of foreigners for U.S. goods and services are much smaller but have similar effects.)

Multiplier Effect

SUPPOSE ONE OF THE manufacturers of television sets mentioned earlier decides to build a new plant to manufacture color TV sets. Assume that $1 million goes for wages to workers, $2 million for construction material and $1 million to buy equipment. Total investment—$4 million.

National income, however, would rise much more than $4 million.

The construction workers save part of their wages. The remainder is spent for food, clothing, shelter, furniture, automobiles, etc. Part of what they spend is received as wages by workers in garment, furniture and automobile industries. For these workers, the expenditures of the construction workers become additional income. They, in turn, purchase goods and services and set aside savings.

Thus, an increase in investment, through the "multiplier effect," can set off a series of repercussions that result in a much larger increase in the national income.

The multiplier can be calculated by economists if they know how consumers will divide their new income between spending and savings. Suppose the economists estimate the multiplier is "three." A $4 billion increase in investment will be multiplied three times, resulting in a $12 billion increase in the national income.

The multiplication effect of a single shot of new investment eventually melts away because people save part of their new income.

Unfortunately, a decrease in investment can cause the multiplier to work in reverse. If investment falls by $4 billion, and the reverse multiplier is three, then the national income will fall by $12 billion.

The accelerator and the multiplier work together like a multi-stage rocket. An increase in demand causes investment to rise. The additional investment magnifies income which in turn may raise the demand for goods and services.

The combined multiplier-accelerator effect helps make shifts in spending of consumers, business and government highly significant.

Soviet Investment. Most economists agree that one explanation for recent Soviet growth is that Communist leaders are channeling a large share of the nation's production into investment. Soviet investment in 1955 was estimated to be about two-thirds of the investment of the United States, measured in dollars. A much larger share of the Soviet investment, however, was devoted to industry, and a much smaller share to housing and consumer services than in the United States.[4]

The Significant Role of Government Spending and Taxing

GOVERNMENT SPENDING and taxing have a marked effect on the economy. About one-fifth—roughly $100 billion—of the Gross National Product was purchased by government in 1960. Another $37 billion was collected in taxes and then transferred back to individuals as personal income.

The far-reaching effects on the economy of one change in the laws made by government may help illustrate the influence of government.

Suppose, for example, personal income taxes were reduced.

What might happen? (*It may be helpful to trace changes in Figure 1.*)

Obviously, people would have more spendable income.

They could either spend it on more goods and services which, in turn, would cause an increase in the Gross National Product, or they could put it into Personal Savings and that would cause things to happen all over the economy.

Chances are people—being people—would do a little of both.

The money they spend on additional goods and services would, naturally, stimulate the economy and result in increased business activity. This could result in increased employment.

Increased employment would result in more personal income for more people and this, in turn, would raise the amount of spendable income—and the cycle starts all over.

The money people save would provide additional capital for business to expand its productive facilities which, in turn, would increase the Gross National Product and also would probably provide more jobs for more people.

More jobs mean more Personal Income and Spendable Income and the cycle receives another thrust.

Increased business activity and more personal income means more business and personal taxes for government—federal, state and local.

But if government takes in fewer dollars because of the tax cut, government *may* spend less on goods and services.

So, it is possible that the rise in private spending may be offset by the fall in government spending.

If, however, the government doesn't cut spending after the tax cut it must borrow to maintain its outlays.

If it borrows from savers, then it spends money which the savers might have spent.

So, where is the net gain to the economy as a whole?

Or, the government may borrow from the Federal Reserve or from commercial banks, thereby creating new purchasing power funds.

But this may mean inflation.

Inflation will follow, unless somehow the economy rolls upwards to new highs in per capita output to offset the greater

number of dollars which are in circulation.

And so it goes.

The meaning is clear.

Activity in one part of our economy affects all other parts.

Demand and Inflation

WE HAVE SEEN THAT three major groups buy the goods and services that make up our national product. The total demand of these groups—consumers, producers who buy capital goods, and government—is called "aggregate demand."

If the three buyers—consumers, producers, and government—are trying to buy more goods and services, production will tend to increase. *But the supply of goods and services may not go up as fast as the aggregate demand.* The prospective buyers, therefore, will bid up the prices of the existing goods and services. Prices will rise.

Conversely, if aggregate demand drops, production tends to drop. This results in less employment and declining prices.

In both situations, the "accelerator" and the "multiplier" may accentuate the trend.

Pamphlet 5 on the Role of Government explained how government can influence the supply of money through the Federal Reserve Board and by its borrowing.

We know that monetary expansion, including the easing of credit, can promote spending; monetary contraction can restrain spending.

But, changes in the money supply do not *necessarily* affect spending. To learn how the supply of money affects spending, we have to trace our analysis back to individual consumers and investors.

Although consumer spending is strongly influenced by the level of disposable income, psychological factors may have a far-reaching effect.

These psychological factors are especially important in consumer decisions on "durable" goods—such things as houses, appliances, and automobiles. If millions of people decide to

postpone buying a house because they expect prices of houses to go down, the economy will be materially affected.

Investment spending has always varied more than consumer spending.

Every economist would agree on the importance of continuing investment. A study a few years ago showed that the addition of 100 new factory workers to a plant could mean an increase of 296 people in the community, 112 households, 41 school children, 107 passenger cars registered, 4 retail establishments with $360,000 more in retail sales. The total increase in personal income throughout the community as the result of the addition of the 100 new jobs was estimated at $590,000.

These, of course, are only representative figures. The effects of increased manufacturing employment in specific communities will depend upon the type of factory, the nature of the labor force, the nature, size and utilization of present community facilities, and many other factors.

Many complex factors enter into the decision of businessmen to invest—the international situation, the political, social and economic climate, tax laws, labor-management relations, technological changes and innovations, and so on. But, generally, businessmen invest in new factories and new equipment because they believe there will be a demand for new or better goods and services, and they will be able to earn a profit from their investment.

Government spending, of course, hinges on social and political pressures as well as on "hot" or "cold" wars.

While the connections between spending, supplies of goods and services, and prices are complex and controversial, there is general agreement on the following two statements:

1. When the economy is operating close to full employment with few idle resources, an increase in spending by consumers, investors or government will probably raise prices more than it will increase production.

2. Conversely, when the economy is in a slump with many idle resources, including unemployed workers, some increases in spending by consumers, investors or government can stimulate production with relatively little impact on the price level.

Our Free and Dynamic Economy Has Its Ups and Downs

EXPERIENCE HAS CLEARLY shown that competitive forces are not always strong enough or fast-acting enough to maintain ideal levels of employment and production. Competition is not perfect. It is weakened by monopoly, rigid prices and wages, government intervention, and human shortcomings—including those resulting from bad judgment and lack of information.

Some instability is one of the prices we pay for our freedom and progress. Most consumers and businesses are free to make the most of their opportunities in a fast-changing society. We cannot expect perfect stability or exactly the same amount of growth year after year.

We cannot escape some fluctuations but we do want to escape the extreme changes of depressions and run-away booms.

A few flashbacks into history may help us spot some strategic factors in the business cycle.

The Collapse, 1929-1933

JUST BEFORE THE crash of 1929, few people seemed to realize the country was on the brink of economic disaster. Most people were looking forward to continued prosperity.

Then production, employment and purchasing power skidded. From 1929 to 1933, the national output declined from $104 billion to $56 billion. Employment fell. By 1933, 13 million workers were jobless. Spendable income dropped by $38 billion. Personal savings disappeared. Corporations, as a group, suffered a loss of $3 billion.

Unlike industrial production, agricultural output did not contract. But agricultural prices collapsed because of the decline of consumer purchasing power.

Economists see two important chain reactions that reinforced each other during this period.

One was the cumulative effect of reduced consumption that led to reduced production which, in turn, led to further reduced consumption.

The other was the far-reaching repercussions of declining investment.

Most economists now believe that the "tight" money policy adopted in 1931 served to slow up recovery. Some of them believe the serious conditions which prevailed from 1931 to 1933 were primarily the result of avoidable errors in monetary policy.

The Slow Revival, 1933-1940

FOR MANY REASONS, consumer spending and business investment began to pick up in 1933 and expansionary forces were set in motion. During the partial revival from 1934 to 1937, the expansionary forces were not strong enough to re-establish tolerable levels of employment and production. Economic snowballs roll easily downhill; pushing them uphill may be more arduous.

War Mobilization, 1940-1945

MOBILIZATION OF OUR economic resources for war beginning in 1940 solved many of our economic problems. It also created new ones.

As government spending greatly increased, employment and production rose rapidly.

Employment zoomed from less than 46 million in 1939 to 54 million in 1944. The real value of the Gross National Product increased by 68% during this period.

But other problems were in the making—inflationary pressures, governmental controls, economic bottlenecks, insufficient investment in new productive facilities and a maladjusted world economy.

Postwar Cycles, 1946-1961

SOME ECONOMISTS predicted great unemployment following World War II and demanded giant government spending programs to ease it. As we all know now, massive unemployment never materialized.

The war years were followed by considerable inflation. During the war, many people greatly improved their cash position, but were unable to buy all of the things they wanted because of wartime shortages. As the money supply expanded because of deficit financing, too much money chased too few goods. Wages and prices rose. A series of wage-price spirals began. Inflation became a continuing problem.

Since World War II we have had several mild, brief recessions. In all of them, personal income and consumption expenditures—"the heroes of postwar recessions"—have remained high.

Recently, there has been a rising trend in unemployment—apparently due, in large part, to technological improvement, shifting demands and the inability of some areas to adapt to economic changes.

In appraising the problems of unemployment and inflation, we should try to maintain our perspective.

J. A. Livingston, a business writer, has pointed out:

> Premier Nikita S. Khrushchev twice visited the United States. He has seen the lineup of automobiles outside factories and supermarkets. He has noticed the wide variety of clothes, household wares, and foods in stores. And he has been plied with facts such as these:
>
> Three out of four families have automobiles. Three out of four families have savings accounts. Three out of five urban families have savings accounts. Three out of five urban families own their own homes (subject to mortgages, of course). An even larger proportion of rural families are homeowners.
>
> Moreover, 14 percent of United States families own stocks in American corporations. This doesn't mean that everyone is wealthy, or that most workers are shareholders.
>
> It does mean that more and more families are able to put something aside for investment after their living expenses. In 1955, only one family in 10 owned stocks, and in 1952 only one in 12, as against today's one in seven.
>
> More significantly, whereas one-third of the families in 1929 had buying power of about $2000 at today's prices, by 1947 that proportion had fallen to one-sixth, and today it's down to one in eight. These include farm families, whose cash income is augmented by farm produce, retired couples who own their own

homes, and single persons just starting to earn their living. Furthermore, in spite of recessions . . . "real" per capita income has risen 28 percent since 1947, and more than doubled since the Great Depression.

This hardly indicates that capitalism as it's practiced in the United States is outmoded or failing to meet the needs of the people.

But it is failing to comply with Communist doctrine. Americans refuse to roll over and play dead according to the Marx-Lenin script.[5]

But if there is room for pride in our accomplishments, there is no room for complacency. In meeting the economic challenge, we cannot afford to ignore the nagging problems of unemployment, inflation, and growth.

This pamphlet has presented us with the "big picture" of our economy—how the parts fit together. This information will be useful background for the material in Pamphlet 7 (*Meeting the Economic Challenge*) which will explore the problems of unemployment and inflation, while we seek to achieve balanced economic growth.

In the discussion session on that pamphlet, we shall examine what we—*as citizens and consumers, as employers or employees* —can do to help solve these problems.

NOTES

1. "The Fallacy of the 'Public Sector'", Murray N. Rothbard, *New Individualist Review,* University of Chicago. Chicago, Ill. Summer, 1961. p. 3.
2. "A Comparison of Soviet and United States National Product." Morris Bornstein. *Comparisons of the United States and Soviet Economies,* Joint Economic Committee, Congress of the United States. 1959. p. 382
3. Ibid, p. 388
4. Ibid, p. 388
5. "Americans Stray Way Off Our Marx." J. A. Livingston. Financial editor, Philadelphia Bulletin, syndicated columnist. *The Washington Post.* August 6, 1961.

GLOSSARY

Acceleration expresses the stimulative effect of an increase in consumption expenditures on investment.

Business sector contains all firms, institutions, and organizations that produce goods and services for sale at a market price intended to cover the costs of production. In addition to the usual private enterprise operating for profit (such as ordinary business firms, farmers, lawyers, doctors, etc.) the business sector also includes mutual institutions, government enterprises, owner-occupied houses, cooperatives, and nonprofit institutions serving business.

Capital consumption allowances include: depreciation charges, accidental damage to fixed capital, and capital outlays charged to current expense. Each of these elements represents part of the reduction in capital goods during the production period. The total therefore represents the amount of capital goods that has been used up during a period.

Government purchases of goods and services include total governmental spending for goods and services, except certain capital transactions. They do not include transfers, interest, subsidies and loan transactions.

Government sector includes all the agencies of the federal, state, and local governments except the current accounts of the government enterprises, which are included in the business section. Purchases on capital account by government enterprises are considered current expenditure of the government sector. The net interest payments and the operating surplus or deficit of government enterprises are also a part of the government sector.

Gross private domestic investment consists of three classifications of business purchases: new construction, producers' durable goods, and the change in business inventories. The change in business inventories represents either an increase or decrease in the amount that business has invested in stocks on hand.

Gross National Product or Expenditure is the market value of the output of goods and services produced by the Nation's economy, before deduction of depreciation charges and other allowances for business and institutional consumption of durable capital goods. Other business products used up by business in the accounting period are excluded. The Nation's economy in this context refers to the labor and property supplied by residents of the Nation. Gross national product comprises the purchases of goods and services by consumers and government, gross private domestic investment (including the change in business inventories), and net foreign investment.

Gross savings are the total of personal savings, corporate savings (retained corporate profits), and business reserves, mainly for depreciation.

Multiplier expresses the stimulative effect of an increase in investment on income.

National income is the total compensation of employees, business and professional income, income of farm proprietors, rental income of persons, corporate profits and net interest. It includes payments for productive services. It does not include gifts, welfare benefits and other payments that are not directly linked to production.

Net foreign investment shows the change that has taken place in the assets (including the monetary gold stock) and liabilities of the rest of the world account. The assets and liabilities in the rest of the world account change because of imports and exports of goods and services, payment of factor incomes to nonresidents and receipts by residents of factor incomes from abroad, and the net balance of cash gifts and contributions sent abroad.

Net national product is gross national product less capital consumption allowances. It reflects the net gain to the economy from production.

Personal consumption is the total spending of individuals and non-profit institutions for food, clothing, housing and rent.

Personal income is all income that accrues to people, including wages, salaries, profits, rental income of persons, dividends, personal interest income and transfer payments.

Personal saving is that part of disposable income not spent for consumption purposes.

Personal sector covers essentially the consuming public as income receivers, spenders, tax payers and savers. It also includes, however, nonprofit institutions and private funds.

Spendable or disposable income is that part of personal income which people have left after paying personal (mainly income) taxes. It is available for their disposal, as consumption expenditures and personal savings.

Transfer payments are income for which no productive services are rendered currently, for example, social security and veterans' benefits.

Suggested Reading

United States Chamber of Commerce, *Business and Economic Forecasting*, Washington, D. C. $ .50. A step-by-step outline of the procedures used by economists in making economic forecasts.

United States Chamber of Commerce, *The National Income and Its Distribution*. Washington, D. C. 1960. Discusses the national economic accounting system.

United States Congress, Joint Economic Committee, *Comparisons of the United States and Soviet Economies*, U. S. Government Printing Office. 1959, $1.90. Papers submitted by experts on the Russian economy to the Subcommittee on Economic Statistics before which they appeared as panelists.

U. S. Department of Commerce, *Survey of Current Business*, Washington, D. C. $4 per year; single copy $.30. Monthly report, including many statistics, on the operation of the economy.

United States Department of Commerce, *National Income 1954*, Washington, D. C. 1954. $1.50. For basic background material. Contains detailed statistics and description of conceptual framework, sources and methods used.

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